

Denial of Discharge - § 727
Dischargeability of debt - § 523(a)

Kimm v. Shane, Adversary No. 03-6339-fra
Kelly Shane, Case No. 03-62842-fra7

5/2/2005 FRA

Unpublished

Defendant borrowed money from Plaintiff in her individual capacity to provide funds for her business, a corporation ("RTI") wholly-owned and operated by Defendant. Defendant sold her business (the assets and name of business) to a third party, with Plaintiff and other creditors to be paid out of the proceeds. Defendant testified that a tender of payment was made, but was rejected by Plaintiff. In any case, the entire proceeds of \$91,000 were paid from escrow to Defendant and the receipt of funds was later characterized by Defendant in her tax records as a loan from her corporation.

In 2001, Plaintiff obtained a judgment in state court against RTI for amounts owed and for attorney's fees. In 2002, Plaintiff obtained a judgment in the same court against Defendant, RTI, and two successor corporations, finding that the transfer of sales proceeds to Defendant was a fraudulent transfer and ordering that the transfer be avoided. A money judgment was entered against Defendant in the same amount as the previous judgment against RTI, as well as a supplemental money judgment for attorney's fees and costs. Defendant filed bankruptcy under chapter 13 in 2003, confirmation of her plan was denied, and the case converted to chapter 7.

Plaintiff filed an adversary proceeding against Defendant seeking denial of discharge under § 727 and, alternatively, a finding that Plaintiff's debt is nondischargeable under §§ 523(a)(2)(A) and (a)(4). As to the § 727 claims: the court held that Plaintiff either failed to submit sufficient evidence to sustain his burden or that the particular claim alleged was not applicable to the facts of the case. The finding of a fraudulent transfer under state law was not the same as a transfer fraudulent under § 727. As to § 523(a)(2)(A), the allegations of fraud occurred after the initial loan was made, and there was no evidence that the debt had been obtained through fraud. §523(a)(4) was not applicable to the facts of the case, as there was no fiduciary relationship between the parties as that term is defined for that section. A judgment was entered dismissing the adversary proceeding.

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:)	Bankruptcy Case No.
)	03-62842-fra7
KELLY J. SHANE,)	
)	
Debtor.)	
)	Adversary Proceeding No.
P. JOHN KIMM,)	03-6339-fra
)	
Plaintiff,)	
vs.)	
)	
KELLY J. SHANE,)	
)	MEMORANDUM OPINION
Defendant.)	

The Plaintiff has a claim against the Debtor, reduced to judgment, arising out of a loan. Plaintiff seeks a judgment declaring the obligation to be excepted from discharge, 11 U.S.C. § 523(a), or, alternatively, that the Debtor be denied any discharge pursuant to 11 U.S.C. § 727. Because the Court finds that there is insufficient evidence to sustain any of these claims, a judgment will be entered dismissing this adversary proceeding.

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1 I. FACTS

2 Prior to 1999, Defendant borrowed money from the Plaintiff in
3 her individual capacity. The purpose of the loan was to provide
4 funds for Rogue Transportation, Inc. (RTI), an incorporated business
5 wholly owned and operated by the Defendant.

6 The record contains no information regarding repayment terms.
7 Defendant testified that the parties' relationship was difficult,
8 and that payments were erratic.¹ Defendant testified to several
9 offers to repay the obligation in full, each of which was rejected
10 by the Plaintiff.

11 Defendant sold her business in July of 1999. More precisely,
12 she entered into an agreement whereby the assets of the business,
13 including its name, were sold to a third party. The sale agreement
14 provided that Plaintiff and other creditors would be paid out of the
15 proceeds. Defendant testified that a tender was made, but rejected
16 by the Plaintiff. Be that as it may, the entire sale proceeds of
17 just over \$91,000 were paid directly from escrow to the Defendant.
18 This was later characterized in Defendant's tax records as a loan
19 from the corporation to the Defendant. The sale closed on or about
20 July 6, 1999; checks were disbursed to the Defendant on July 6 and
21 July 23.

22 On July 20, 2001, Plaintiff obtained a judgment in the
23 Circuit Court for Josephine County, Oregon against RTI in the amount
24 of \$29,295.14. An additional award in the amount of \$8,993.57 was

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26 ¹Plaintiff did not testify.

1 made on August 14, 2001 for attorneys fees. Interest runs on the
2 judgment at the statutory rate of 9% per annum from the date of
3 judgment.²

4 In June of 2002, Plaintiff filed an action against Defendant
5 herself, as well as Rogue Transportation, Inc., and two successor
6 corporations, XXYZ, Inc. and Shane's Distribution, Inc. (SDI). The
7 complaint, also filed in the Circuit Court for Josephine County,
8 alleged that the payment of the sale proceeds discussed above
9 constituted a fraudulent transfer. The Circuit Court agreed, and,
10 on November 26, 2002, entered a judgment and decree finding that the
11 transfers of July 6 and July 23, 1999 were fraudulent, and ordered
12 that they be avoided. The Court further ordered that a money
13 judgment against Defendant Shane be entered in the same amounts as
14 were entered against Rogue Transportation, Inc. in the prior case.
15 A supplemental money judgment for costs and attorney fees in the
16 amount of \$19,631.02 was made in March 2003.

17 No payment has been made. Defendant filed her petition for
18 relief under Chapter 13 of the Bankruptcy Code on April 10, 2003.
19 This Court declined to confirm the Debtor's proposed plan of
20 reorganization, and the case was converted to one under Chapter 7 on
21 June 20, 2003.

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25 ² Defendant's narrative about the origin of the loan suggested that the original loan was to her
26 personally; however, the two judgments of the Circuit Court indicate that the original loan was to the
corporation, not the Debtor.

1 II. DISCUSSION

2 1. *Sufficiency of Service*

3 Plaintiff commenced this case by filing his complaint with
4 the Court and sending a copy of the summons and complaint to
5 Defendant's attorney. The Defendant herself was never served,
6 notwithstanding the terms of Fed.R.Bankr.P. 7004.

7 The deficiency of service was raised in the Defendant's
8 Answer, and preserved in the pre-trial order. However, no attempt
9 was made to obtain, prior to trial, a ruling as to sufficiency of
10 service. The Court notes that the matter came to trial only after
11 extensive discovery and at least two postponed trial dates.
12 Moreover, it took approximately 1½ years to bring the matter to
13 trial.

14 A defense of sufficiency of service is deemed waived if not
15 seasonably asserted. See e.g., Macrialucin v. S.S. Galecia, 723
16 F.2d 994, 997 (1st Cir. 1983). The Defendant was fully apprised of
17 the claims against her, at the very latest, by the time the pre-
18 trial order was signed and lodged. The issues raised by the
19 complaint were fully tried. If the defect in obtaining personal
20 jurisdiction is to be dispositive, it should be raised soon enough
21 to avoid such circumstances. Accordingly, the Court finds that the
22 defense of inadequate process was waived.

23 2. *Plaintiff's Claims*

24 Plaintiff asserts five causes of action, which the Court will
25 discuss in order:
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2 a. Plaintiff's first claim for relief is for denial of
3 discharge under 11 U.S.C. § 727(a)(2), alleging that the Debtor
4 transferred funds or assets to SDI within a year of the petition for
5 relief. § 727(a)(2) provides that discharge may be denied if a
6 debtor, with intent to hinder, delay or defraud a creditor or an
7 officer of the estate, transfers or conceals property of the debtor
8 within one year of the petition date. The record does reflect
9 transfers made by the Debtor to SDI in January, 2002, and again in
10 the following April. Since the Defendant's petition for relief was
11 filed on April 10, 2003, only the second transfer is within the
12 ambit of § 727(a)(2), and only if the transfer was made after April
13 10, 2002. Since the burden of proof is on the Plaintiff to prove
14 that the transfer occurred within one year of the petition for
15 relief, the ambiguity should be resolved against him.

16 Assuming the transfer was within a year of the petition date,
17 the record does not support a finding that the transfer was
18 fraudulent. Defendant was indebted to RTI (and SDI, its successor)
19 by virtue of the loans from SDI from the proceeds of the sale of
20 SDI's assets. Moreover, the transfers from SDI to the Debtor were
21 subsequently avoided by the Circuit Court's November 26, 2002
22 judgment. In effect, the Circuit Court ordered that the money
23 "borrowed" by Defendant from RTI/SDI be repaid. Under the
24 circumstances, it cannot be said that any transfer from Defendant to
25 her corporation was without consideration. Remember as well that the
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1 judgment debtor at the time of the transfers by the Defendant was
2 the corporation, not the defendant. It follows that the transfer
3 was not fraudulent as to Plaintiff. Indeed, the transfer could not
4 be deemed to be prejudicial to any creditor of the Defendant in
5 light of the corporation's (and its creditors) superior claim to the
6 funds.

7 b. Plaintiff's second claim for relief for denial of
8 discharge, pursuant to 11 U.S.C. § 727(a)(4), alleges that the
9 Debtor knowingly and fraudulently made false oaths or accounts in
10 connection with her bankruptcy case. The Plaintiff points to
11 several instances in which the Defendant improperly listed accounts
12 or obligations as personal instead of corporate, or vice versa. As
13 noted above, the Defendant did a poor job of maintaining an
14 appropriate distinction between personal and corporate obligations.
15 However, there is no evidence to demonstrate that any
16 misrepresentations or omissions were made with fraudulent intent.

17 c. Plaintiff asserts that, since Defendant was the sole
18 officer, director and shareholder of SDI, she should be denied a
19 discharge pursuant to 11 U.S.C. § 727(a)(7). Code § 727(a)(7)
20 provides that a debtor will be denied a discharge if she has
21 committed, within one year prior to the debtor's petition date, any
22 acts specified in § 727(a)(2), (3), (4), (5), or (6) in connection with
23 another bankruptcy case filed by an insider of the debtor. While SDI
24 and the Debtor would be classified as insiders under the Bankruptcy
25 Code, § 101(31), SDI did not file bankruptcy in its own name.

1 Accordingly, § 727(a)(7) is not applicable.

2 d. The remaining claims for relief allege that the particular
3 debt owed by the Defendant to Plaintiff should be excepted from
4 discharge under either § 523(a)(2) or § 523(a)(4).

5 Section 523(a)(2)(A) excepts from discharge a debt for money
6 or property to the extent obtained by false pretenses, a false
7 representation, or actual fraud. As noted above, the original
8 obligation was incurred not by the Debtor, but by her corporation.
9 There is no evidence that the original obligation arose from any act
10 of deceit, either by the Defendant or the actual borrower. What
11 followed may have been a breach of many promises to pay, but these
12 breaches did not themselves give rise to the liability. Breach of a
13 promise to pay a pre-existing debt does not, by itself, justify
14 exception from discharge. In re Woodall, 177 B.R. 517, 523 (Bankr.
15 D.Md. 1995) ("the fraud must have existed at the time of, and been
16 the methodology by which, the money, property or services were
17 obtained." [internal citation omitted]). Plaintiff's claim, to the
18 extent it is premised on the fraudulent transfer judgment, is not
19 excepted from discharge under § 523(a)(2): a fraudulent transfer
20 under state law is not the same thing as a liability premised on
21 fraudulent or deceitful conduct.

22 Section 523(a)(4) excepts from discharge a defalcation by a
23 fiduciary. Nothing in the record suggests a fiduciary relationship
24 existed between the parties here. It is true that, under Oregon
25 law, a director and officer has a fiduciary obligation to the
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1 corporation, and, by extension, to the corporation's creditors.
2 However, this is not the sort of fiduciary relationship contemplated
3 by § 523(a)(4). Cal Micro, Inc. v. Cantrell (In re Cantrell), 329
4 F.3d 1119, 1125 (9th Cir. 2003) ("[T]he fiduciary relationship must
5 be one arising from an express or technical trust that was imposed
6 before and without reference to the wrongdoing that caused the
7 debt." [internal citation omitted]).

8 III. CONCLUSION

9 Plaintiff has failed to provide sufficient evidence to find
10 that discharge should be denied under 11 U.S.C. § 727 or that
11 Plaintiff's debt should be excepted from discharge under 11 U.S.C. §
12 523. Accordingly, and for the foregoing reasons, the Plaintiff's
13 complaint should be dismissed.

14 The foregoing constitutes the Court's findings of fact and
15 conclusions of law, which will not be separately stated.

16 Counsel for Defendant shall prepare a form of judgment
17 dismissing this adversary proceeding with prejudice.

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20 FRANK R. ALLEY, III
21 Bankruptcy Judge
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